Supreme Court of the United States

OCTOBER TERM, 1943.

No. 490

TRICO PRODUCTS CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT OF PETITION.

ARTHUR A. BALLANTINE,
GEORGE E. CLEARY,
Counsel for Petitioner.

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Trico Products Corporation,
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PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Trico Products Corporation prays that a writ of certiorari issue to the United States Circuit Court of Appeals for the Second Circuit to review a judgment of that Court rendered in the above cause on August 19, 1943 (R. 390), affirming a decision of the United States Board of Tax Appeals (now known and herein referred to as the Tax Court) finding a deficiency in the federal income tax of petitioner of $413,439.31 for the calendar year 1934 and of $1,220,933.44 for the calendar year 1935 (R. 105). Except for small deficiencies aggregating $16,440.86 which were not contested on appeal, these deficiencies were for corporate surtaxes assessed under Section 102 of the Revenue Act of 1934, 48 Stat. 702. The petition presents

questions of great importance generally as to the basis of the heavy penal tax provided for by that Section.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended (28 U. S. C. A. § 347(a)).

The Opinions of the Courts Below.

The opinion of the Tax Court (R. 46) is reported in 46 B. T. A. 346. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 370) is reported in 137 F. (2d) 424.

Statute Involved.

Section 102, *Revenue Act of 1934*, 48 Stat. 702, so far as here material, provides as follows:

> "Sec. 102. *Surtax on Corporations Improperly Accumulating Surplus.*
>
> "(a) Imposition of Tax.—There shall be levied, collected, and paid for each taxable year upon the adjusted net income of every corporation (other than a personal holding company as defined in section 351) if such corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting gains and profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:
>
> "(1) 25 per centum of the amount of the adjusted net income not in excess of $100,000, plus

"(2) 35 per centum of the amount of the adjusted net income in excess of $100,000.

"(b) Prima Facie Evidence.—The fact that any corporation is a mere holding or investment company, or that the gains or profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a purpose to avoid surtax.

"(c) Definition of 'Adjusted Net Income'.—As used in this section, the term 'adjusted net income' means the net income computed without the allowance of the dividend deduction otherwise allowable, but diminished by the amount of dividends paid during the taxable year."

Summary Statement of Matter Involved.

Petitioner maintains that the heavy penalty surtax assessments made in this case were based on fundamental errors of law made by the lower courts.

Petitioner's position is that under a correct construction of Section 102 of the Revenue Act of 1934, a corporation is subject to the penalty surtax imposed thereby only where the fact-finding tribunal determines on the evidence that the purpose of preventing the imposition of individual surtax liability on shareholders was at least a substantial factor inducing the accumulation of profits. The Tax Court made an error of law in construing the statute as imposing liability unless the complete absence of such a purpose is shown. The reviewing court failed to correct this fundamental error. The construction of the statute here sought to be reviewed conflicts in principle with *United States* v. *Wells*, 283 U. S. 102 (1931), a "contemplation of death" case. Both courts also erred in failing to recognize that the *prima facie* effect given by the statute to a finding of accumulation beyond reasonable business needs disappears

upon introduction of positive evidence as to the actual purposes of the accumulation. This construction is in conflict with the recent decision of the Circuit Court of Appeals for the 9th Circuit in *Hemphill Schools, Inc.* v. *Commissioner,* 137 F. 2d, 961 (1943).

The Tax Court in this case made no finding that the purpose of preventing the imposition of surtax on shareholders was a substantial factor inducing the accumulations made by the petitioner in the taxable years 1934 and 1935 and sustained the assessments on an erroneous construction of the statute. The reviewing court did not and could not have made the finding essential to liability. Such a finding as to purpose is not made unnecessary by the finding of the Tax Court, on conflicting evidence, that petitioner's accumulations had been beyond reasonable business needs since substantial, affirmative and undisputed evidence was introduced that the accumulations were actually motivated by purposes wholly unrelated to tax considerations.

Facts.

The accumulations in question were for 1934 and 1935 (see p. 9 below). The significance of these accumulations and the motives which induced them must be determined in the light of the setup and practice of the petitioner. The legal points presented are clear, but a statement of the facts in some detail is necessary to indicate their bearing and importance in this case.

Petitioner in 1934 and 1935 was a substantial, growing manufacturing company—not a mere holding or investment company—actively engaged in making automatic windshield wipers for automobiles under patents expiring in 1942 (R. 47-48). It had approximately 1,780 stockholders in 1934 and 2,200 stockholders in 1935 (R. 176). Its largest single individual stockholder owned directly and indirectly

about 23% of the stock; he and a group of some 20 other original stockholders owned directly and indirectly about 76% of the stock (R. 355, 364). Petitioner concededly was not formed for the purpose penalized by the statute; it made no loans to stockholders; its stockholders had transferred no income-producing property to it for stock or as paid-in surplus. It paid substantial and increasing dividends from year to year (R. 58) under an established and publicly announced dividend policy adopted in 1928 and continued, without change, through 1934 and 1935, the tax years in question (R. 57).

This is the first case in which a corporation, so situated, has been held by the courts to be subject to the penalty surtax under Section 102 or similar sections of the Revenue Acts.

Formation and Growth of Petitioner.

J. R. Oishei, the President of the petitioner, started the business in 1917 and organized petitioner in 1920 (R. 47). The real growth of the business dates from 1921, when Mr. Oishei invented the automatic vacuum windshield wiper, which ultimately became standard equipment on practically all automobiles (R. 67). Earnings, which were applied principally to building up the Company, grew as follows (R. 48, 61, 323, 325):

1920	$ 52,000
1925	509,000
1926	921,000
1927	1,372,000

1927 Recapitalization and Sale of Stock.

The dividend practice of petitioner in all years subsequent to 1927, including the years 1934 and 1935 here in question, was a natural and legitimate outgrowth of a recapitalization and sale of stock which occurred in that

year. In September, 1927, the then stockholders, 21 in number (R. 48), after recapitalizing the Company so that its outstanding stock consisted solely of 675,000 shares of no par value common stock (R. 50), sold 175,000 shares (26%) to bankers (R. 50) who resold these shares to the public at $31 per share (R. 310) or for some $5,425,000. At that time the Company's net tangible assets were only about $1,800,000 (R. 310, 316)—less than $3 per share—its earning power was based almost entirely on basic patents expiring in 1942 (R. 48), and it was earning at the annual rate of $1,370,000—about $2 per share (R. 61). It was publicly announced that the stock sold to the public would be placed on an annual dividend basis of $2.50 per share (R. 310, 316). This dividend rate on the entire 675,000 shares would have required annual dividends of $1,687,500, more than the Company was earning.

This otherwise impossible sale of stock was made possible by the provisions of certain contracts (R. 272-289), insisted upon by the bankers (R. 94), which had no relation to tax considerations, and which operated as the primary cause of the dividend practice thereafter followed by the petitioner. Under the contract between all of the then stockholders and the Company (R. 279), the stockholders agreed that 450,000 of the 500,000 shares retained by them should be restricted by a "waiver" of dividends thereon up to $2.50 per year. This provision reduced the current annual dividend requirement on the $2.50 per share basis to $562,500 payable on the 225,000 shares of "free" stock. This involved, however, a large increase over the dividends which petitioner had paid in prior years (R. 319, 325).

The dividend waiver under this contract was specifically stated to be "in consideration * * * of the conservation of earnings and working capital which this agreement

contemplates for the Company'' (R. 280). The waiver was to be effective only until the earnings of the Company increased to specified amounts per free share plus the number of shares to be freed by such earnings. 112,500 shares were to be released from the dividend waiver in 1928 or later, as the corporate net earnings reached $5.00 per share or $1,687,500 for the last share in the $5 block. Another 112,500 shares were to be released in 1929 or later, as the corporate net earnings reached $6.00 per share or $2,700,000 for the last share in the $6 block. The remaining 225,000 shares were to be released as the corporate net earnings reached $9.00 per share or $4,050,009 to release the first share, and $6,075,000 to release the last share in the $9.00 block (R. 280). No release could be made in any year unless $2.50 per share had been paid on the free shares in the preceding twelve months (R. 281). The Company also agreed not to liquidate voluntarily or recapitalize so long as any stock was subject to the dividend waiver (R. 282). The latter provision, while protecting the purchasers of the free stock against liquidation before assets had been substantially increased, also had the effect of limiting the sources from which petitioner could derive new cash capital or otherwise build up its assets to accumulated earnings and profits (R. 55).

Under the terms of the sale the restricted stock, all held by the old stockholders, was required to be placed in a voting trust to the end that the Company should ''be managed and directed during the next ten years under a definite and fixed policy'' (R. 272, 284). The voting trust was superseded in 1929 by the transfer of the restricted shares to Trico Securities Corporation, the stock of which was owned by the original stockholders of petitioner (R. 56). (The agreement with the bankers did not, as erroneously stated

by the Circuit Court of Appeals (R. 372), contain the provision for release of the restricted shares. This was a provision of the contract between the Company and the stockholders (R. 280-1).)

Thus from the outset the controlling stockholders, as the holders of the 450,000 shares of restricted stock, which was not marketable, had a goal of building up petitioner's assets and thereby increasing earnings to a point where the stock could be released, making it worth on the market $13,950,000 (on the basis of a $31 a share market price for the free stock), and entitling it to share equally with the other shares in all dividends distributed.

In placing before the management this strong inducement to accumulation, the purchasers of the free shares were insuring an effort on the part of the management to increase earnings and to build up the assets of the Company, so slender at the start, toward the sale price per share, were guarding against any voluntary liquidation of petitioner by the old stockholders before asset value had increased substantially, and also were making provision against the consequences of the expiration in 1942 of the Company's vital patent. There was no conflict of interest between the holders of the free and the restricted shares —the release of the restricted shares could be accomplished only by a process of building up assets and earnings, which would be beneficial to all.

Earnings and Distributions from 1928 through 1933.

The "definite and fixed" dividend practice of petitioner from 1928 through 1933 was to pay annually the publicly announced dividends of $2.50 per share on its free stock and no dividends on its restricted stock on which such dividends had been waived (R. 57). The resulting distribu-

tions, in comparison with the earnings, were as follows (R. 58, 300):

	Net Income per books	Dividends	% of net income distributed
1928	$ 1,797,821.56	$ 655,243.09	36.45
1929	2,249,947.97	794,131.49	35.30
1930	1,908,415.88	914,052.47	47.90
1931	1,762,550.76	937,484.10	53.18
1932	964,964.32	937,484.85	97.15
1933	1,418,277.21	937,485.01	66.10
Total	$10,101,977.70	$5,175,881.01	51.23

The dividends declared in 1927 had been but $357,023.38 (R. 319). This included dividends on preferred stock held by the old stockholders and retired as part of the recapitalization plan in 1927 (R. 55) and the quarterly dividend on the free shares paid January 2, 1928. Dividends prior to 1927 had been much smaller (R. 325). The immediate effect of the new dividend policy was thus a substantial increase in dividends.

During the period from 1928 through 1933, there was no substantial increase in the amount invested in operating assets, and the difference between earnings and distributions was largely accounted for by investments in securities of some $4,000,000 (R. 59, 299). Petitioner's status at December 31, 1933 has at no time been questioned by the Government, so far as Section 102 is concerned, and hence must be regarded as furnishing no basis for assertion of liability under Section 102 (see R. 23-25).

Earnings and Distributions in 1934 and 1935 and Later Years.

During 1934 and 1935, the tax years in question, petitioner continued its established policy of paying annually $2.50 on its free stock and no dividends on its restricted

stock (R. 57). Its earnings for 1934, and for 1935 when the automobile business greatly expanded, and the disposition thereof, were as follows (R. 58, 59, 61, 67):

	1934	1935
Earnings	$1,771,558.53	$3,567,404.42
Dividends	937,485.62 (53%)	925,322.70 (26%)
Difference	$ 834,072.91	$2,642,081.72
Less:		
Increase in operating assets	296,251.00	$1,801,967.31
Purchase of treasury stock*	.....	476,224.29
		$2,278,191.60
Balance	$ 537,821.91	$ 363,890.12

If petitioner had distributed an additional dividend of 80¢ per share on all its stock in 1934 and 54¢ per share in 1935, or an aggregate of $901,712.03 for the two years, it would have distributed every dollar of 1934 and 1935 income not reflected in increased operating assets or paid out to acquire treasury stock. Under the decision of the Court below, petitioner is penalized a total of $1,617,931.89 (R. 29, 32) for permitting these accumulations to take place.

The increase in the amount of securities held at the end of 1935 over the amount held at the end of 1933 (R. 59) reflected in part a large increase in current liabilities (R. 60) as well as increases in reserves for depreciation and amortization of patents (R. 299).

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* These purchases were made in connection with a 10-year contract between petitioner and General Motors Corporation, its largest customer, which provided for payments by petitioner to General Motors, by way of participation in profits. Petitioner had the option of making annual settlements either in cash or in its own stock (R. 63).

The dividend practice begun in 1928 was continued without substantial change up to the date of the hearing in December 1940, except that extra dividends of $1.37½ per share were paid on all the shares in 1936 and 1937. These exceptional distributions were made because of the tax imposed on Undistributed Profits in those years (R. 57). That tax was later repealed (see p. 35 below).

Shares Owned by Largest Stockholders in 1934 and 1935.

During the tax years in question, the largest individual stockholders, directly and through Trico Securities Corporation, held the following percentages of petitioner's outstanding stock:

	Jan. 1, 1934	Jan. 1, 1935	Dec. 31, 1935
John R. Oishei	22.9%	23.2%	23.5%
Peter C. Cornell	20.8%	21.7%	21.9%
C. H. Oishei	12.2%	10.5%	5.2%
S. H. Evans	9.7%	9.7%	10.0%
Ieuan Harris	4.3%	4.4%	4.7%

(Percentages computed from data at R. 355 and 364.)

The balance of the stock was held in smaller amounts by some 1,780 to 2,200 other stockholders (R. 176).

Release of Stock from Dividend Waiver.

Although the petitioner's earnings decreased due to the depression as shown at page 9, *supra,* the earnings steadily increased after 1932 and reached $4,184,560 in 1936 (R. 61). This growth was due both to expansion of the business and growing investments in securities. Petitioner's earnings

resulted in the release of shares from the dividend waiver as follows (R. 61, 290):

Released by earnings of	Shares released after close of year	
1927	49,460	
1928	63,040	(last of $5 block)
1929	37,491	
1935	75,009	(last of $6 block)
1936	14,951	(first of $9 block)
Total shares released	239,951	

The shares so released, which were virtually unmarketable as restricted shares (R. 159, 176, 182), had a market value as free shares of more than $7,400,000 on the basis of a sale value of $31 per share. The free shares, which had sold for $31 per share in 1927, were selling at $34 per share at the time of the hearing in December, 1940; in the interval they had fluctuated from a low of $19 to a high of $62 per share (R. 66, 182). The 450,000 shares of stock originally subject to the dividend waiver had a potential value of $13,950,000 as free shares at $31 per share.

Other Objectives Accomplished.

In addition to releasing over half of the restricted stock by 1937, notwithstanding the depression, the dividend practice of petitioner enabled the substantial accomplishment of the other objectives of the 1927 agreements, including the insuring of annual dividends of $2.50 per share on all free shares, the progressive increase of the annual earnings of the Company and the building up of the net asset values behind the stock. The net asset value per share, which was about $3 per share in 1927 when the free shares were sold to the public at $31 per share, increased to $10.37 per share

by December 31, 1933 and to $15.14 per share by December 31, 1935 (computed from data at R. 299).

The dividend practice followed also enabled petitioner to meet a number of other problems peculiar to its unique position in the automobile industry. From 1932 on, petitioner was practically the sole supplier of automobile windshield wipers for automobiles (R. 67). A substantial part of its business was with the largest automobile manufacturers (R. 68) over which petitioner had no control. This made it absolutely essential for petitioner at all times to have sufficient resources promptly to meet the needs and demands of the automobile industry, which was rapidly expanding in 1934 and 1935 (R. 67, 184-186). By reason of the 1927 contracts petitioner could not recapitalize and would find it difficult to borrow (R. 55). Under the dividend policy of petitioner, it was possible to meet this need. From the beginning of 1934 to the end of 1939 petitioner's investment in operating assets increased by over $5,600,000 (R. 59). From 1936 to 1939 petitioner expended almost $2,400,000 for additions to productive capacity because it was unable with its previously existing facilities to take care of the demands of the industry although operating under three 8-hour schedules (R. 69). Its gross sales during those four years were equal to gross sales for the *eight* years from 1927 to 1935, inclusive (R. 68).

Petitioner was also confronted with the fact that in 1942 the basic patents were to expire on the windshield wiper, which was its major source of income. To meet this problem it conducted extensive experiments in search of new products, and at the end of 1935 set aside a large fund for anticipated diversification of products (R. 70, 71, 320). This policy bore fruit in the form of an automatic device for raising and lowering automobile windows, intro-

duced to the automobile trade in 1940 and enthusiastically received by it (R. 71, 297). The adoption of this device on 1,000,000 cars a year would require plant expansion by petitioner of an estimated cost of between $3,000,000 and $5,000,000 and would double petitioner's production (R. 72).

Thus, the dividend policy of petitioner was designed to meet the peculiar requirements of this Company, as well as to carry out the purposes of the 1927 contracts. That this policy was not the result of motives on the part of the principal stockholders which conflicted in any respect with general corporate purposes, whether by way of tax considerations or otherwise, is further shown by the fact that it had the full approval of an independent director, Paul A. Schoellkopf, representing Niagara Share Corporation, which had purchased in the market 16,000 free shares (R. 49, 227-231).

Effect of Dividend Policy on Tax Liability of Principal Stockholders.

It is far from the fact that the 21 original stockholders diminished their own receipt of dividends by causing petitioner to follow the dividend practice described. The fact is that, despite the sale in 1927 of a substantial part of their stock in the Company, they increased their receipt of dividends. The dividends payable on the 50,000 free shares which the old stockholders retained in 1927, plus the additional shares subsequently freed and owned by them directly or indirectly, were as follows (computed on the basis of $2.50 per share on 50,000 shares plus shares released):

1928	$248,650
1929	306,250
1930–1935	499,977.50 per year
1936	687,500
1937	724,877.50

In addition there were the extra dividends of $1.37½ per share on all the shares in 1936 and 1937, paid because of the undistributed profits tax in effect for those years (R. 57).

The dividends received from 1928 on were much larger than had been received by the old stockholders on the common stock in any year prior to 1928 (R. 319, 325).

In the cases of J. R. Oishei and P. C. Cornell, the two largest stockholders of petitioner, the increase in dividends payable on free stock which they owned directly or indirectly was as follows:

	Dividends at $2.50 per share on free stock owned directly or indirectly at December 31—	
	1927	1935
Mr. Oishei*	$29,542.50	$153,220.00
Mr. Cornell*	34,558.50	150,837.50

Additional shares were released in 1936 and 1937, thereby further increasing the dividends payable to the principal stockholders (R. 61).

From a long range viewpoint, the practice followed had the effect of building up the incomes of the controlling shareholders and the value of their holdings in the only way in which this could be done, that is by building up petitioner's earnings by expanding the investment in plant, equipment and operating capital as rapidly as possible and keeping surplus funds invested in securities pending their absorption into the manufacturing business. The entire

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* As of December 31, 1927 Mr. Oishei owned directly or indirectly only 11,817 free shares, and Mr. Cornell only 13,783 shares (R. 363). As of December 31, 1935 Mr. Oishei owned directly 43,288 free shares and was beneficial owner of about 31% of the 57,260 free shares then held by Trico Securities Corporation; and Mr. Cornell owned directly 44,015 free shares and was beneficial owner of about 28% of the 57,260 free shares owned by Trico Securities Corporation (R. 355, 364).

accumulations up to the end of 1935 were actually absorbed in operating assets within four years thereafter (R. 59).

Turning to the other side of the picture, namely, the alleged surtax savings from failure to make additional distributions, the Tax Court stated that in 1934 and 1935 the controlling stockholders "saved in surtaxes not less than $840,000" (R. 96). This conclusion rests on fallacy. It was based on computations as to surtaxes which would have been paid currently if every dollar of 1934 and 1935 income had been distributed as dividends (R. 366). This would have required additional distributions of over $3,475,000 for the two years, when actually there was available for distribution from the income of those years, after increases in operating assets and purchases of treasury stock, only $901,712.03 (see computation above, page 10). If petitioner had distributed as dividends all of its income for 1934 and 1935 not reflected in increase in operating assets and purchases of treasury stock, the additional current surtaxes of the stockholders in question for both 1934 and 1935 would have been less than one-fourth of the amount assumed by the Tax Court. For the more important year 1935, such distribution would have been but 14½% of the distribution assumed by the Tax Court.

The Testimony.

Respondent's only witness was an auditor who testified as to certain computations (R. 246-250).

Petitioner's witnesses included the representative of the bankers in the 1927 transaction and the bankers' counsel. They also included a majority of petitioner's Board of Directors in 1934 and 1935. These directors were the individuals whose "purpose" was to be ascertained. All testified without contradiction that neither the 1927 contracts

nor the dividend practice based thereon were entered into or adopted for any purpose of avoiding surtaxes on the shareholders, and that tax considerations had not entered into the matter at any time (R. 160, 170, 177, 225-228, 233, 234, 236, 237, 239).

This testimony did not consist merely of categorical denials of the existence of the condemned purpose. It was coupled with positive and unshaken testimony concerning the facts and circumstances surrounding the matter, showing that the dividend practice was adopted and continued in the light of and on the basis of the 1927 contracts. The direct testimony of the witnesses, supported by the evidence as to facts and circumstances, was that the accumulations had two complementary purposes: (a) to increase corporate earning power and thereby secure by the only available means the release as soon as possible of additional shares from the dividend waiver, thus building up the current incomes (and consequently the taxes) of the principal stockholders, and greatly increasing the value of their holdings, as well as fulfilling the other purposes of the 1927 contracts (R. 158, 172, 173, 176, 177, 199, 229, 235, 236, 239, 242), and (b) to take care of the growing business needs of the Company to keep it in a strong position as sole supplier to the automobile industry of an indispensable accessory and to enable it to expand and develop new products, particularly in view of the fact that it could not issue new stock and would find it difficult to borrow and of the expiration in 1942 of the basic patents on the windshield wiper (R. 184-186, 189, 203-204, 224-225, 229-230).

There was substantial, affirmative and uncontradicted evidence that the actual purpose of the accumulation of profits was wholly other than that of avoidance of surtaxes. There was no affirmative evidence that surtax avoidance was a motivating purpose.

The Decisions Below.

The Tax Court, after finding all of the subsidiary facts as to which there is no dispute, including the mathematical fact that if additional distributions had been made the shareholders would have paid currently greater surtaxes, found (a) that during the taxable years petitioner permitted its gains and profits to accumulate beyond the reasonable needs of its business, and (b) in the language of the statute, that during the taxable years petitioner was availed of for the purpose of preventing the imposition of the surtax upon its shareholders and the shareholders of another corporation through the medium of permitting its gains and profits to accumulate instead of being divided or distributed (R. 73).

It is clear from the opinion of the Tax Court, however, that in purporting to make the finding as to purpose, essential to liability, it erroneously construed the statute as not requiring the condemned motive to contribute substantially, or to any material degree, in causing the accumulation. Thus, the Tax Court stated that there must be a "complete lack of the condemned purpose" (R. 89); that it must be convinced of "the complete innocence of petitioner's purpose" (R. 89), and that "there was no taint of a purpose" to avoid surtaxes (R. 98); that petitioner must prove a "complete lack" and "absence" of the condemned purpose "regardless of what other purposes it may prove" (R. 89, 90); and that "the pecuniary weight of the tax saving was so overwhelmingly greater than the benefit derived by the majority stockholders from the release of shares that it is difficult to believe that it was only the latter and never the former

to which they allowed their purposes to stray" (R. 95).* The Tax Court's finding as to purpose, although couched in statutory language, in fact was not a finding that the purpose of preventing stockholders' surtaxes actually played a material or substantial part in causing the accumulations. When read in the light of the opinion, the finding was no more than a finding that petitioner had failed to prove the "complete lack" of the purpose penalized by Section 102, or that no "taint" of such a purpose existed.

The Circuit Court of Appeals stated that it could not "subscribe to the view (of the petitioner) that the prevention of the imposition of surtaxes must have been shown to have been the *dominant* factor behind the accumulations" (R. 374-5) without indicating the reason for or the bearing on this case of that conclusion. The Court overlooked the fact that the Tax Court had failed to find that the prevention of the imposition of surtaxes had been even a *substantial* factor behind the accumulations, but had proceeded on a wholly erroneous view of what the statute requires. The Circuit Court of Appeals did not purport to supply the lack of the finding as to purpose which was essential to liability, the absence of which it failed to recognize, nor would it have any authority or basis for doing so.

Both the Tax Court and the Circuit Court of Appeals misconceived the effect of the finding of an accumulation beyond the reasonable needs of the business and treated such finding as evidence of the existence of the purpose surviving the introduction of positive evidence of the actual purpose of the accumulation. Each seemed to proceed on the basis that to negative liability petitioner must disprove

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* On petitioner's computation, the theoretical tax saving was greatly overstated by the Tax Court—the figure for such saving being less than one-fourth of that used by it—while the benefits to the holders of restricted shares through release of the shares were greatly understated. (See pages 11-12 and 15-16, *supra*.)

such an accumulation, and failed to recognize that even though the Tax Court found that there was such an accumulation, no liability could attach if it was shown that the purpose of the accumulation was not that of preventing the imposition of surtaxes.

Questions Presented.

Petitioner does not base its request for a review by this Court on the ground that there was no substantial evidence to support the finding that profits were accumulated beyond the reasonable needs of the business, although the only direct evidence on the point was to the contrary, respondent did not produce a single witness to testify on this question of business judgment and petitioner regards that finding as incorrect. That finding is not decisive of surtax liability

The position of petitioner is that, notwithstanding the finding as to accumulation beyond reasonable business needs, the sustaining of liability in this case was based on vital errors.

The questions presented are:

1. Can corporate surtax liability be imposed on a corporation under section 102, Revenue Act of 1934, without a finding that the purpose of preventing the imposition of individual surtaxes on shareholders was a substantial factor in inducing the accumulations by the corporation? Upon the introduction of positive evidence as to the actual purposes of the accumulation, does not the *prima facie* effect given by section 102(b) to a finding of accumulation beyond reasonable business needs disappear from the case?

2. Did the Tax Court in the present case make a finding that the purpose of preventing the imposition of individual

surtaxes was a substantial factor in inducing the accumulations of the petitioner penalized by the Commissioner; and, would any such finding have been warranted?

Helvering v. *National Grocery Co.*, 304 U. S. 282 (1938), and *Helvering* v. *Chicago Stock Yards Co.*, 318 U. S. 693 (1943), the only decisions of this Court dealing with this penalty surtax, do not support the decision below. In those cases the Court held on the facts that the condemned purpose was an inducing cause and liability was sustained, but the cases are clearly distinguishable on material facts.

In each of those cases there was much more than a mere accumulation of profits beyond reasonable needs, and the current payment of less surtaxes by stockholders than would have been payable had larger distributions been made. In each there was a single stockholder, and there were large loans to the sole stockholder. In each case it was specifically found that the purposes which were claimed to have motivated the accumulations could have been served equally as well by the accumulation of the funds in the hands of the sole stockholder as by the accumulation of the funds in the corporation.* Such is not the fact here.

In the present case, by contrast, no stockholder owned more than 23.5% of the stock, there were many hundreds of stockholders, no loans were made to stockholders, and

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* "Mr. Prince, the sole stockholder, if in receipt of the respondent's earnings, could equally well have done what the respondent proposed to do, that is, turn accumulated earnings into invested capital." (*Helvering* v. *Chicago Stock Yards Co.*, 318 U. S. 693, 701-2.)

"Since Kohl was the sole owner of the corporation, the business would have been as well protected against unexpected demands for capital, and assured of capital for the purpose of any possible expansion, by his personal ownership of the securities as by the corporation's owning them. Moreover, no conceivable expansion could have utilized so large a surplus. The high taxes were first imposed in 1919. After that time no dividend was paid until after the close of the taxable year here involved." (*Helvering* v. *National Grocery Co.*, 304 U. S. 282, 294.)

the legitimate purposes of the controlling stockholders could be carried out only through building up *petitioner's* capital and income (which was accomplished notwithstanding the payment of substantial and increasing dividends from year to year) and which could not have been accomplished by accumulation of funds in the hands of the stockholders.

Moreover, in the two cases cited the stockholders merely denied the existence of the condemned purpose, without affirmative evidence of surrounding facts and circumstances to support their denial. Here the 1927 contracts constituted positive, forceful proof which dissolved the Government's *prima facie* case, leaving no basis for the finding of the existence of the condemned purpose.

Reasons Relied on for the Allowance of the Writ.

The decision below erroneously imposes liability under Section 102 of the Revenue Act of 1934 in the absence of a finding by the Tax Court that the avoidance of surtaxes on shareholders was a substantial factor inducing the accumulation of profits. This construction of the statute is inconsistent in principle with the decision of this Court in *United States* v. *Wells,* 283 U. S. 102 (1931), construing a statute imposing a tax on a transaction motivated by a particular purpose. The Court there held that transfers of property were subject to estate tax as made in contemplation of death only where the thought of death was the impelling, controlling, inducing or dominant motive of the transfer. (See further discussion of this case in petitioner's brief, page 29.)

The decision below erroneously applied subdivision (b) of Section 102 by treating the finding that profits were accumulated beyond the reasonable needs of the business as *prima facie* evidence of the existence of the condemned

purpose surviving the introduction by petitioner of evidence of the actual purpose inducing the accumulation. This conflicts in principle with the recent decision of the Circuit Court of Appeals for the 9th Circuit in *Hemphill Schools, Inc.* v. *Commissioner*, 137 F. 2d, 961 (1943).

The decision below erroneously imposes liability under Section 102 on an active manufacturing company, with widely held stock, where all that is found is accumulation beyond the reasonable needs of the business and the current payment of less surtaxes by stockholders than would have been paid had larger distributions been made, and where there was substantial, affirmative and undisputed evidence that the accumulation was motivated by purposes wholly unrelated to tax considerations. Under the decision below the *sole* defense against liability under Section 102 would be proof, satisfactory to the Tax Court, that no part of the corporate accumulation was beyond reasonable business needs. If reasonable men could differ on that question, a corporation could not safely accumulate profits even for business needs, and in no event could it accumulate for a non-business need, even though in the judgment of the directors the accumulations were essential, wise or necessary to accomplish some wholly legitimate purpose having nothing whatever to do with the avoidance of shareholders' surtaxes.

Furthermore, there could be no review of the Tax Court's decision in any case where there was any substantial evidence to support a finding of accumulation beyond reasonable business needs even though the taxpayer introduced overwhelming, persuasive and uncontradicted evidence that the actual purpose of the accumulation was wholly other than a purpose of preventing surtaxes. The tax would in effect become one on undistributed profits regardless of actual motive.

The Court below therefore decided an important question of Federal law, of far reaching importance and application, which has not been but should be settled by this Court.

The questions involved in this case are of unusual general importance at the present time because of the pressing need that business corporations retain adequate reserves for the post-war period, without risk of heavy penalties if the Commissioner and the Tax Court differ with the judgment of the directors. Under the decision directors of all business corporations will be under great pressure in every year of good earnings to distribute as dividends amounts which they in good faith believe should be retained to meet present and future needs. They will be apprehensive that the Commissioner of Internal Revenue, substituting his judgment for theirs, may hold that profits have been permitted to accumulate to some extent beyond the reasonable needs of the business, and may infer merely from that holding that a motive of surtax avoidance played some part in causing the accumulation, with the consequence of penalty surtaxes on the corporation under Section 102 and threat of personal liability on the directors for the action taken by them. They will be unable to rely on knowledge, however well founded, that accumulation is actually motivated by legitimate purposes wholly other than a purpose to avoid shareholder's surtaxes, as a defense against a penalty tax which by its terms is directed only against accumulations made for the purpose of avoiding surtaxes on shareholders.

It has already been found, through the costly experiment of the undistributed profits tax in effect for 1936 and 1937, that any statute thus causing business corporations to make unwise and unduly large distributions may have the most serious consequences in the future and seriously impair the ability of corporations to continue as fruitful income producers, taxpayers and employers of labor.

Taxpayers generally, the administrative officers and the Congress are entitled to know authoritatively whether the view of the law approved below is to prevail. In the *National Grocery* case this Court said "We granted certiorari because of the importance in the administration of the revenue laws of the matter presented" (304 U. S. 282, at 286), and in the *Chicago Stockyards* case a similar statement was made (318 U. S. 693, at 693-4). The construction of the statute as applied to corporations having but a single stockholder, as in those cases, is of far less general importance than its construction in the present case, where it was applied for the first time to an active business corporation having hundreds of stockholders, paying large dividends, and making no loans to stockholders. For the reasons pointed out above, business corporations generally need have no apprehension that the decisions in the *National Grocery* case and the *Chicago Stock Yards* case may be applicable to them. The decision in the present case, however, raises new problems which vitally affect a wide range of ordinary business corporations with widespread stockholdings. The questions are of vital and general importance, particularly in view of post-war re-employment problems, and should be determined by this Court.

WHEREFORE, petitioner respectfully prays that a writ of certiorari issue under the seal of this Court to review the decision of the Circuit Court of Appeals for the Second Circuit in the above case, and that said decision be reversed.

TRICO PRODUCTS CORPORATION,
Petitioner.

By ARTHUR A. BALLANTINE,
GEORGE E. CLEARY,
Counsel for Petitioner.